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MEMORANDUM FOR: Director of Central Intelligence
THROUGH: Deputy Director (Intelligence)
SUBJECT: Paper on Current Economic Situation
and Trends in Western Europe

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1. The subject paper with annexes, enclosed in two copies, has been prepared for your information and is in response to the request contained in the referenced memorandum.



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OTTO E. GUTHE
Assistant Director
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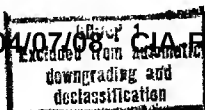
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**THE CURRENT ECONOMIC SITUATION AND TRENDS
IN WESTERN EUROPE**

5 November 1962

Office of Research and Reports

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THE CURRENT ECONOMIC SITUATION AND TRENDS
IN WESTERN EUROPE

Summary

As the year 1962 nears an end, the rate of growth of business activity in Western Europe is leveling off at a pace which, although substantial, is considerably below the rates that prevailed during 1958-60. The outlook for the next 12 to 18 months is for continuance of the present rates of growth at 4 to 5 percent, based on an expectation of certain shifts in demand for European output, and an accompanying moderate deterioration in the balance of payments position of the major European countries that will bring a moderate improvement in the basic US balance of payments position.

1. General Economic Trends

Stimulated by the completion of postwar recovery in Europe, rising incomes over most of the world, increasing demand for industrial products, and the imminence of a new tariff structure for the six countries of the Common Market, business activity in Western Europe rose rapidly after 1957. The average rate of growth of industrial production in Western Europe as a whole increased from less than 2 percent in 1958 to a remarkable 10 percent in 1960 (see Table 1*). The main impetus to growth came from a high level of investment activity within Europe (in part reflecting a move by US and other noncontinental industries to acquire productive assets behind the Common Market tariff wall) and from a rapidly rising level of exports both to

* P. 6, below.

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other European countries and to the rest of the world, including the US (see Table 2*). In very large part, also, the high level of business activity was consciously promoted by government policies in Western Europe.

The rapid expansion of European exports during this period was traceable to the improved competitive position of Europe in world markets. Productive capacity was being modernized and expanded rapidly, and European prices remained relatively constant. Labor productivity in important sectors rose significantly as a result of the new capacity. In the larger continental countries, productivity rose more rapidly than did wages. Profits expanded, and prospects were bright. At the same time, rising US prices and sagging export efforts enabled European goods to compete more successfully with US commodities throughout the world.

The decline in the rate of growth of European industrial production that began in 1960 resulted from an expected decline in the volume of foreign investment in the Common Market countries, from declining rates of domestic investment as rising wages and less rapidly rising prices narrowed profit margins, and from a slowing pace in the growth of exports. Foreign investment, which had flowed to Europe in anticipation of the Common Market tariff wall, declined as large international companies acquired productive capacity on the Continent. The movement of private US capital into Europe reached a peak in 1960, reflecting the volume of direct investment by US corporations and of new foreign security issues marketed in the US. The flow of private US capital to Europe, although declining since 1960, remains high.

Since 1959, average prices in Europe have been rising. Furthermore, revaluation of the German mark and the Dutch guilder in March 1961 raised those countries' prices in terms of other currencies. Meanwhile the general level of US wholesale prices has shown no net change since 1958, and average prices of industrial commodities have been stable since 1959. The resulting improvement in the US competitive position has been accompanied by declining rates of export growth for European countries. The declining rate of increase in export volume has been due not only to more intense competition

* P. 7, below.

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for world markets but also to rising consumer demand within Europe (see Table 3*). Rapidly rising wages coupled with a high level of employment apparently have permitted people throughout Europe to make effective a latent demand for a wide variety of consumer goods and thus have supported significant increases in living standards at all income levels.

2. US-European Trade

Trade between the US and Western Europe has reflected the divergent growth rates and price trends that have characterized the two large industrial areas since 1958. Between 1958 and 1960, when European industrial production was expanding rapidly, the US economy recovered only slowly from the 1958 recession. After 1960, however, as US economic activity quickened, the rate of European economic expansion declined. US exports to Europe changed little between 1958 and 1959, but in 1960 they increased by nearly 40 percent. At the same time, however, US imports from Europe increased by nearly 40 percent in 1959, but in 1960 they actually declined. In 1961, US exports remained at the high level of the preceding year (\$6.3 billion), while US imports continued to decline, but by only 3 percent.

As a result of these changes, the US export surplus to Europe, which in 1958 was \$1.2 billion and was eliminated in 1959, not only reappeared but was nearly doubled in 1960, reaching \$2.1 billion. In 1961 this export surplus rose slightly, to \$2.2 billion. During the first half of 1962, US imports from Europe again started to rise, and although exports continued upward, the more rapid import expansion caused a decline in the export surplus (see Table 4**).

3. Prospects

In the second half of 1961 the decline in European industrial growth leveled off from an average annual rate of 8 percent in 1958-60 to one of 4 to 5 percent, a rate that has been maintained thus far in 1962. The preponderance of economic opinion, both in the US and in Europe, expects the current rate of

* P. 8, below.

** P. 9, below.

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European economic growth to be maintained through 1963. Although certain pockets of unemployment persist, notably in the UK and Italy, employment remains high and consumer demand strong. The two European countries whose growth rates have declined most, Germany and the UK, have been depleting inventories for the past 12 to 18 months and are expected to initiate inventory replacement in the near future. With most European governments committed to a policy of sustained growth, they are prepared to invoke appropriate countercyclical monetary and fiscal measures whenever necessary to maintain a high level of production and employment. Indeed, Germany and the UK already have initiated action. In most of the other large European countries, however, such measures are not now necessary.*

As a result, the aggregate demand of Western Europe for imports from the US is expected to remain high, although significant shifts should occur in its commodity composition. The shift from investment demand to consumer demand as the dynamic force in the economies of Western Europe is likely to result in a decline of US exports of machinery and metal manufactures. Furthermore, the initiation of the Common Agricultural Tariff by the European Economic Community (EEC) made effective on 31 July 1962 is expected to result in some reduction of US exports of foodstuffs to the six EEC countries. At the same time, however, the increased weight of European consumer demand should result in a substantial expansion of the market for consumer goods and related materials and equipment. Beyond this, the determinant of whether US exports to Europe will be equal to or greater than their present level lies in the administration of recent US trade legislation.

The manner in which the tariff-cutting authority contained in the Trade Act of 1962 will be administered in practice and the levels of income actually achieved in the US and Europe will be the critical factors in US - West European trade. Should excess capacity develop in Europe and become widespread, should prices cease to rise and should wages level off or decline, and should these eventualities coincide with rising US prices and wages, then US imports from Europe probably would expand rapidly, US exports to Europe would contract, and the US export surplus could be converted into a

* For brief accounts of economic prospects in the major Western European countries, see the attached Annexes.

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sizable import surplus. Even under such conditions, however, dumping by European producers in the US market would be unlikely because of the buoyant conditions postulated for the US. In order for dumping in the usual sense -- that is, sales abroad below domestic prices and cost -- to be widespread, it would be necessary for markets both in Europe and in the US to be undergoing stagnation or contraction. Such conditions appear unlikely for the foreseeable future.

Although the slower pace of economic growth in Western Europe may result in some decrease in the value of US exports to the area, it seems likely that the over-all effect on the US balance of payments will prove to be beneficial. Exports to Europe are likely to remain high because European incomes are expected to rise and because reciprocal tariff reduction is expected to be followed by export expansion. Although rising US income will be accompanied by rising imports, as long as US prices remain competitive, imports will rise no more rapidly than income. Thus, if European and US incomes grow at roughly the same rate, and especially if tariff revisions are followed by expansion of exports, it seems likely that the US export surplus with Europe will remain at approximately the current level. Attracted by investment opportunities, US business in the past few years has made very sizable investments in Western Europe, contributing thereby to the US balance of payments deficit. The currently slower rate of economic growth in Western Europe, and particularly the slackening of planned investment activities, may be expected to reduce US exports of capital to the area, decreasing thereby the US balance of payments deficit on capital account.

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Table 1
Rates of Growth of Industrial Production
in Western Europe
1957-62

	Percent		
	<u>Europe</u>	<u>EEC ^{a/}</u>	<u>EFIA ^{b/}</u>
<u>Annual</u>			
<u>1958</u>			
<u>1957</u>	1.5	2.9	0.0
<u>1959</u>			
<u>1958</u>	6.0	6.3	5.0
<u>1960</u>			
<u>1959</u>	9.9	11.8	7.2
<u>1961</u>			
<u>1960</u>	4.5	6.4	1.5
Quarterly (seasonally adjusted)			
<u>1961</u> (1st quarter)			
<u>1960</u>	5.2	7.1	1.5
<u>1961</u> (2nd quarter)			
<u>1960</u>	5.2	6.4	2.2
<u>1961</u> (3rd quarter)			
<u>1960</u>	3.8	4.6	2.2
<u>1961</u> (4th quarter)			
<u>1960</u>	3.1	5.6	0.0
<u>1962</u> (1st quarter)			
<u>1961</u>	4.3	6.1	0.7
<u>1962</u> (2nd quarter)			
<u>1961</u>	4.3	6.0	0.7

Source: Organization for European Cooperation and Development, Main Economic Indicators, August 1962.

a. European Economic Community.

b. European Free Trade Area.

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Table 2
Annual Changes in the Level of Exports
of Western European Countries
1958-62

	Percent		
	<u>OECD a/</u>	<u>EEC b/</u>	<u>EFTA c/</u>
<u>1958</u> <u>1957</u>	-0.5	+1.1	-2.4
<u>1959</u> <u>1958</u>	+8.3	+11.0	+4.8
<u>1960</u> <u>1959</u>	+14.3	+17.7	+9.0
<u>1961</u> <u>1960</u>	+7.4	+8.8	+5.2
<u>1962 (first half)</u> <u>1961 (first half)</u>	+6.3	+7.0	+4.7

Source: Organization for European Cooperation and Development, Main Economic Indicators, August 1962.

- a. Organization for European Cooperation and Development.
- b. European Economic Community.
- c. European Free Trade Area.

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Table 3
Annual Changes in the Level of Imports
of Western European Countries
1958-62

	Percent		
	<u>OECD a/</u>	<u>EEC b/</u>	<u>EFTA c/</u>
<u>1958</u> <u>1957</u>	-6.6	-7.6	-6.0
<u>1959</u> <u>1958</u>	+5.7	+5.5	+6.2
<u>1960</u> <u>1959</u>	+18.4	+22.3	+15.3
<u>1961</u> <u>1960</u>	+6.4	+8.6	+2.0
<u>1962 (first half)</u> <u>1961 (first half)</u>	+7.1	+10.9	+2.7

Source: Organization for European Cooperation and Development, Main Economic Indicators, August 1962.

- a. Organization for European Cooperation and Development.
- b. European Economic Community.
- c. European Free Trade Area.

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Table 4

US Trade with Western Europe:
Value and Rate of Change
1958-62

	US Exports to <u>Western Europe</u>	US Imports from <u>Western Europe</u>	Net US <u>Exports</u>
	<u>Billion Dollars</u>		
1958	4.5	3.3	1.2
1959	4.5	4.5	Negl.
1960	6.3	4.2	2.1
1961	6.3	4.1	2.2
January-June			
1961	3.1	1.9	1.3
1962	3.3	2.3	1.0
	<u>Annual Rates of Growth (Percent)</u>		
<u>1959</u> 1958	0.5	37.2	
<u>1960</u> 1959	39.3	-7.5	
<u>1961</u> 1960	-0.4	-2.8	
January-June			
<u>1962</u> 1961	4.3	20.3	

Sources: Department of Commerce, WTIS Statistical Reports, Part 3, No. 61-11, and International Commerce, 8 October 1962

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